

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

San Diego Gas & Electric Company

Complainant,

v.

Docket No. EL00-95-000

Sellers of Energy and Ancillary Services
Into Markets Operated by the California
Independent System Operator and the
California Power Exchange

Respondent.

Investigation of Practices of the California
Independent System Operator and the
California Power Exchange

Docket No. EL00-98-000

(Issued August 23, 2000)

MASSEY, Commissioner, dissenting in part:

There is a crisis of confidence in California wholesale electricity markets that threatens to erode the political consensus necessary to sustain a market-based approach to regulation. In these circumstances, the Federal Energy Regulatory Commission must act forcefully and decisively to reassure California market participants, policymakers and consumers that federal regulators will insist that jurisdictional wholesale markets produce consumer benefits and just and reasonable rates. I would grant the relief requested in the complaint and would cap bids into the California ISO and PX markets at \$250/Mwh¹ as a temporary stopgap measure pending the outcome of the section 206 investigation

¹ In order to provide the ISO with the flexibility to maintain reliability, I would not apply the bid cap to Out of Market calls to out of state generator resources or to energy payments in the Summer 2000 Demand Relief Program currently in effect.

initiated by today's order. I am convinced that such a cap is necessary to ensure just and reasonable rates during our investigation.²

In recommending that a price cap be put in place now, I am motivated by a deep concern about the high prices in wholesale markets in California. The Commission has a statutory duty to ensure that wholesale prices are just and reasonable. This is the Commission's fundamental consumer protection responsibility, and the Federal Power Act provides no exception for poorly functioning markets. Indeed, the Commission's primary rationale for promoting market-based policies has been that markets would produce consumer benefits and lower prices compared to cost of service regulation.

There are sufficient indications in this record that California wholesale markets are not producing prices that are just and reasonable. California wholesale electricity costs for June 29 of this year were seven times what they were for the same date in 1999 (\$340 million vs. \$45 million) even though energy usage was only about 3% more.³ Southern California Edison states that during the month of June, 2000, the total cost of electricity (energy and ancillary services combined) charged to the California market was nearly half of California's total electricity cost for all of 1999. In two separate five-day periods in June, 2000 (when demand was at least 3,000 MW to 5,000 MW below the projected annual peak) California's total cost of electricity exceeded \$1 billion, with one of those five day periods reaching \$1.3 billion.⁴ SDG&E provides a comparison of final PX day-ahead prices for the Southern California zone for June and July during 1999 and 2000. During June and July of 1999, prices rarely exceeded \$150/MWh even during the highest load levels. During the same period this year, prices have multiplied to three and four times the levels reached last year whenever load levels exceed 33,000 MW, according to

² The majority order notes that the ISO's existing \$250/MWh purchase price cap effectively limits bids into California, and this appears to be true. Rather than rely totally upon the ISO for temporary price relief, however, this Commission must take firm responsibility for prices in jurisdictional wholesale markets. In most other respects, I agree with the conclusions reached by the majority order. In particular, I endorse opening an expedited section 206 investigation and setting the earliest possible refund effective date, although I disagree with the portion of the text that appears to characterize the prospects for refunds as unlikely. In any event, if refunds are unlikely, it is even more incumbent upon the Commission to ensure that unreasonably high prices are mitigated during the pendency of our investigation.

³ See Attachment B to Notice of Intervention of the Public Utilities Commission of the State of California.

⁴ Motion to Intervene and Response of Southern California Edison Company.

SDG&E.⁵ The California Public Utilities Commission states that every analysis of the California markets since their opening has found substantial exercise of market power.⁶ In these circumstances, the confidence of California consumers in wholesale markets may quickly erode.

The record supports the conclusion that during periods of high demand in California, generator bid prices are virtually unrestrained by the forces that would apply in competitive markets for other commodities. In other markets besides electricity, when the price is too high, consumers purchase less and this in turn has a substantial dampening effect on price. In the California wholesale electricity markets, the willingness of purchasers is largely unaffected by price, and sellers understand this dynamic. In fact, the ISO's Department of Market Analysis concluded that when demand exceeds 40 GW "there is no constraint on how high [generators] might raise their prices in the absence of price caps."⁷

This lack of demand responsiveness appears to have the strong tendency to influence generator bids sharply higher. In high usage hours where no market forces restrain an unbridled price runup, a large transfer of wealth from purchasers to sellers can occur rapidly because all sellers are paid the highest market clearing price. The high prices that wholesale purchasers pay are ultimately passed through to retail consumers, either immediately or over some period of time.⁸

The complainant and interveners identify other serious problems as well in California wholesale markets. The siting of generation is lagging rather sharp increases in demand, which makes it likely that during peak usage all generator bids, regardless how high, must be accepted. There is limited transfer capacity over high voltage transmission wires into California. There have been very limited hedging and forward contracting by wholesale purchasers who have been required by state policy to make the bulk of their purchases through the ISO and PX spot markets. Serious questions are raised about the wisdom of the somewhat unique California market design, required by state law, that provides for separate ISO and PX markets. In addition, this Commission

⁵ Complaint of San Diego Gas & Electric Company.

⁶ Notice of Intervention of the Public Utilities Commission of the State of California, at 8.

⁷ *Id.*, at 7.

⁸ *Narragansett Electric Co. v. Burke*, 381 A.2d 1358 (1977), cert. denied, 435 U.S. 972 (1978). *Nantahala Power & Light Co. v. Thornburg*, 476 U.S. 953 (1986).

has already declared that the ISO's current congestion management system must be completely overhauled.

I do not believe that customers must be required to bear the full economic brunt of the poorly functioning market and high prices that these problems create. I am pleased that the Commission is launching a section 206 investigation, and it is my hope that we will leave no stone unturned in investigating and proposing market-based solutions that will lead to just and reasonable prices.

I must point out, however, that neither the FERC nor state policymakers, acting in isolation from each other, can solve all of these market flaws because our respective jurisdictions are sharply delineated under existing law. State policymakers cannot effectively define or police market power in interstate wholesale markets. They cannot require a wholesale market structure, based upon an efficiently operating interstate transmission grid, that will produce just and reasonable rates. These are federal responsibilities. By the same token, under existing law the FERC cannot site the generation and transmission facilities that are necessary to bring supply and demand into equilibrium, and has no direct authority to require purchasers of power to hedge price volatility risk in forward or financial markets. These are state responsibilities. Both federal and state policymakers have a role in pursuing policies that will facilitate an effective and price-dampening demand side response (where, for example, customers bid "negawatts" into the market).

In short, high prices in California may not ultimately be reduced without a joint effort by federal and state policymakers. We must work together to solve the problems at hand, including joint proceedings and hearings as appropriate.

I would not recommend a \$250/MWh bid cap as a long term solution to these market flaws. I am very much aware that the installation of additional generation facilities is a key part of the solution in California, and our policies must not discourage that investment. Nevertheless, I am convinced that this temporary price cap is necessary pending the implementation of measures to ensure that California wholesale markets produce just and reasonable rates.

For these reasons, I respectfully dissent in part to today's order.

William L. Massey
Commissioner